No. 11-1082

ORAL ARGUMENT HELD FEB. 6, 2012

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

DAN RAPOPORT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission

SUPPLEMENTAL BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

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REGULATIONS AND RULES

The Securities and Exchange Commission, having been granted leave by this Court, submits this supplemental brief regarding the past application of its Rule of Practice 155(b), 17 C.F.R. 201.155(b). The orders discussed below constitute all of the Commission decisions granting or denying motions to set aside defaults that could be located. As we explain, the Commission has denied motions to set aside a default where a party fails to satisfy one or more of the three requirements stated by the rule. This case differs from earlier decisions in that Rapoport, unlike other respondents, specified his proposed defenses in his motion as required by the rule. The Commission's order denying Rapoport's motion, however, is not inconsistent with these prior orders because Rapoport, like the earlier respondents, failed to satisfy each of the other two Rule 155(b) requirements: he did not provide a reasonable explanation for his failure to answer and he did not file his motion within a reasonable time.

A. In prior orders, the Commission has denied motions to set aside defaults where respondents did not satisfy one or more of the prerequisites for such motions, but has granted such motions where respondents satisfied all three prerequisites by filing a timely motion, providing a justifiable reason for the failure to answer, and specifying a defense.

In former Rule 12(d) and current Rule 155(b), the Commission authorized the setting aside of defaults. *Amendments to Rules*, 1964 SEC Lexis 92, at *11–12 (Jun. 30, 1964) (adopting Rule 12(d)); *Rules of Practice*, 60 Fed. Reg. 32738, 32752 (Jun.

23, 1995) (adopting Rule 155(b) and retaining "the existing standards for setting aside a default contained in former Rule of Practice 12(d)"). Rule 155(b), like former Rule 12(d), sets forth three preconditions for seeking relief and states them in the conjunctive: a "motion to set aside a default shall be made within a reasonable time, state the reasons for the failure to appear or defend, *and* specify the nature of the proposed defense in the proceeding." 17 C.F.R. 201.155(b) (emphasis added). "[T]o prevent injustice and on such conditions as may be appropriate," the Commission "may for good cause shown set aside a default." *Id.*

The Commission decisions interpreting Rule 155(b) and former Rule 12(d) fit into four categories. *First*, the Commission has denied motions to set aside defaults where the respondents failed to comply with all three requirements stated in the rule's text: the motions were not filed within a reasonable time, they did not specify defenses, and they did not justify the failure to answer. In *Richards*, the respondent filed a Rule 12(d) motion 20 years after the default, claiming that he did not answer because he did not have notice of the Commission proceedings against him. The Commission denied the motion because it was not made within a reasonable time, because it did "not specify his proposed defense," and because record evidence revealed that Richards "had actual notice" of the proceeding. *In re Richards*, 1994 SEC Lexis 2663, at *3–4, 8 (Aug. 29, 1994). In *Hellen*, the Commission denied a Rule 155(b) motion because Hellen filed it almost a year after the default, because

he did "not state what defense he would advance in this proceeding," and because the Commission did "not believe that Hellen's participation in a divorce proceeding" or his "inability to retain counsel" constituted "adequate reasons or excuses for his myriad failures to defend his appeal" when the record showed that he knew about the proceedings. *In re Hellen*, 55 S.E.C. 248, 250–51 (2001). And, in *Ainbinder*, the Commission denied a Rule 155(b) motion because it was filed four years after the default and because the Commission disbelieved Ainbinder's explanation for his conduct. Ainbinder claimed that he did not file an answer because his attorney told him that one had already been submitted. But the Commission found that Ainbinder still failed to act after learning that no answer had been filed when he received a copy of the default order and confirmed its validity. *In re Ainbinder*, 1997 SEC Lexis 2062, at *2–3 (Oct. 1, 1997) (the Commission order does not indicate whether Ainbinder specified his defenses).

Second, the Commission has denied a *timely filed* motion to set aside a default that did not specify a defense and did not provide a reasonable justification for the failure to answer. In *Bullard*, the Commission found that a request to set aside the default only 5 days after the default was "timely filed." *In re Bullard*, 1995 SEC Leixs 3049, at *3 (Nov. 9, 1995). The Commission nonetheless declined to set aside the default. It found that Bullard "knew of his obligation to file an answer"—he was informed by the Order Instituting Proceedings, his counsel, and the ALJ—but

that he never answered and missed "several opportunities to act in this proceeding." *Id*. at *4. The Commission also noted that while Bullard asserted that he "was not guilty he did not specify the nature of his proposed defense." *Id*. at *3.

Third, the Commission has set aside defaults where the Rule 155(b) motion was filed within a reasonable time, stated a specific defense, *and* demonstrated that a mistake explained the failure to answer. In *Birman Managed Care*, the movant filed its Rule 155(b) motion three days after the default and explained "its mistaken belief that the Answer was due within twenty days of service of the OIP, rather than ten days, as specified in the OIP." *In re Birman Managed Care, Inc.*, 2008 SEC Lexis 2810, at *2 (Sep. 23, 2008). The Commission accepted this explanation, as well as the movant's defense that it did not file periodic reports, as required by Commission rules, because it was in bankruptcy during the relevant time period and could not create those reports. *Id*. In *Kern*, the respondents filed their Rule 155(b) motion 14 days after the default, along with "an explanatory affidavit and a proposed answer to the OIP." *In re Kern*, 2005 SEC Lexis 744, at *4 (Feb. 1, 2005). The ALJ denied the motion, and the Commission reversed. *Id*. at *1. Because the respondents filed the Rule 155(b) motion "promptly," and because the ALJ had not ordered the respondents to show cause before entering the default, the Commission construed the default order as "the equivalent of a show cause order" and construed the Rule 155(b) motion as an "appropriate response." *Id*. at *5.

Fourth, the Commission has granted a motion to set aside a default where the Division of Enforcement consented to the motion in order to complete a settlement with the respondents and the respondents presented a reasonable justification for the default—"their attorney was severely ill and unable to attend to their affairs." *In re Rolandi Secs. Corp.*, 1972 SEC Lexis 738 (Apr. 12, 1972).[1]

[1] While the Court asked for briefing on the Commission's application of its rules for setting aside defaults, we note that the following ALJ decisions, which are not Commission orders, fit within one of the four categories described above. *In re C-3D Digital, Inc.*, 2011 SEC Lexis 323 (Jan. 28, 2011) (Category 4); *In re American Kiosk Corp.*, 2008 SEC Lexis 1460 (Jun. 27, 2008) (Category 4); *In re Harris*, 2005 SEC Lexis 1843 (May 6, 2005) (Category 3). In one decision that fits within the second category, the Division of Enforcement charged a corporation with failing to file required reports while its securities were registered with the Commission. *In re RDM Sports Group, Inc.*, 2009 SEC Lexis 3631, at *2 (Nov. 3, 2009). Despite being served with the OIP, the corporation did not answer and the ALJ revoked the registrations by default. *Id*. at *3. Twelve days later, the corporation filed a Rule 155(b) motion, which the ALJ found was made "within a reasonable time." *Id*. at *5, 12. The ALJ nonetheless denied the motion, finding that the corporation did not "adequately explain[] why it failed to file a timely Answer" because it knew about the OIP but did not answer its charges. *Id*. at *13–14. While the ALJ addressed what was labeled a "proposed defense," the corporation did not actually specify a defense for its past conduct; it conceded that it had failed to file the required reports. Rather, the "proposed defense," which the ALJ rejected, was a proposed "practical solution" for future remediation that would allow resumption of trading in its securities. *Id*. at *14–19.

B. The Commission order under review is not inconsistent with its prior application of the rules regarding defaults because Rapoport did not justify his failure to answer and his motion was untimely.

The Commission's order denying Rapoport's Rule 155(b) motion is not inconsistent with its prior applications of that rule (and former Rule 12(d)). The Commission denied Rapoport's motion based on its finding that his reasons for failing to answer were insufficient and its finding that his Rule 155(b) motion was untimely. JA 18–22. As an asserted justification for the default, Rapoport claimed that he did not know he was required to answer before being personally served with the OIP. JA 18. The Commission, however, found that Rapoport knew about his responsibility to answer by March 2 because he knew about the ALJ's order directing service through his attorney and requiring him to answer by that date. Moreover, the Commission found that his "active engagement in arguing against directed service is inconsistent with his asserted belief that he did not have to respond unless personally served." JA 19–20. The Commission further found that Rapoport did not file his motion within a reasonable time because he did not seek relief until five months after the default judgment and nine months after his deadline to answer. JA 22.

These justifications for denying Rapoport's motion comport with the justifications for past denials given by the Commission in previous orders: the Commission has found that there is not "good cause" to set aside a default when a

respondent does not satisfy one or more of prerequisites stated in the rule's text, and the Commission has found that there is "good cause" only when a respondent satisfies all those requirements. Rapoport's circumstances thus differ from those in *Birman* and *Kern*, where the respondents satisfied all three prerequisites for relief: they filed a timely motion; they reasonably explained their failure to answer, such as by identifying a legitimate mistake regarding the filing date; and they specified a valid defense to the allegations against them. In both *Birman* and *Kern*, the Commission found "good cause" and set aside the default.

Here, by contrast, the Commission found that Rapoport's motion was untimely and that he had no reasonable explanation for his conduct, and its order is thus comparable to the orders in *Richards*, *Hellen*, *Ainbinder*, and *Bullard.* In each instance, the respondent claimed lack of knowledge to justify the failure to answer, and in each instance the Commission described the record evidence supporting its finding that the respondent knew about the proceeding but nevertheless failed to answer. Moreover, as in *Richards*, *Hellen*, and *Ainbinder*, the Commission found that the motion to set aside the default was not timely. While the five-month time gap between the default and Rapoport's Rule 155(b) motion was not as large as the gap in *Richards* (20 years), *Hellen* (one year), and *Ainbinder* (four years), it was still significant when compared with gaps that the Commission found to be reasonable in *Bullard* (5 days), *Birman* (3 days), and *Kern* (14 days).

There is a difference between this case and *Richards*, *Hellen*, and *Bullard*: Rapoport described specific proposed defenses in his Rule 155(b) motion.[2] In discussing those proposed defenses, the Commission explained that "[i]f Rapoport had established that his reasons for the failure to defend the proceeding supported setting aside" the default and that his motion "was filed within a reasonable time," it would then "consider whether his proposed defenses had potential merit." JA 23. Since he did not meet these conditions, the Commission did not consider his defenses, stating that doing so would grant him "the hearing that he chose to forgo by failing to defend the proceeding." *Id*.

This distinction—the specification of defenses by Rapoport—should not minimize the deference owed to the Commission's interpretation of Rule 155(b). The Commission's reasons for denying Rapoport's Rule 155(b) motion are not inconsistent with its prior practice and the text of the regulation, which requires that, *in addition* to specifying proposed defenses, Rule 155(b) motions "be made within a reasonable time" and state the reasons for the failure to appear. *Auer v. Robbins*, 519 U.S. 452, 461 (1997) (an agency's interpretation of its own regulation is "controlling unless plainly erroneous or inconsistent with the regulation"). As the Commission's prior orders demonstrate, it has declined to set aside defaults where a

[2] As noted above, the *Ainbinder* decision did not indicate whether the movant specified any defenses.

movant files an untimely motion and does not provide a reasonable justification for the failure to answer.

Rapoport has suggested that this interpretation is inconsistent with the rule's text because, in his view, "*the plain language* of Rule 155(b) requires a balancing of factors that mandates consideration of proposed defenses." Reply Br. 5 (emphasis added). But the "plain language" of Rule 155(b) requires no such thing. It provides that movants must "specify the nature of the proposed defense," but it does not mention balancing. And by stating the three requirements in the conjunctive, the rule implies that the Commission need not examine proposed defenses if the other two prerequisites have not been satisfied. Rapoport's contention that the Commission must consider proposed defenses even if a Rule 155(b) motion suffers from other deficiencies is not premised upon the rule's text or its prior application by the Commission. Rather, it is based on his incorrect assertion that Federal Rule of Civil Procedure 55(c) governs Commission proceedings, *see* SEC Br. 19–20 & n.4, and his interpretation of some cases interpreting Rule 55(c), which disregards numerous other cases showing that the Commission's interpretation of Rule 155(b) is consistent with how multiple circuit courts interpret Rule 55(c), *see id*. at 23–24 & n.6.

The "post hoc rationalization" rule, which Rapoport cited in his reply brief (at 4) and again at oral argument, does not apply here. *Alpharma, Inc. v. Leavitt*, 460

F.3d 1, 6 (D.C. Cir. 2006) (explaining the "'post hoc rationalization' rule" as "a rule directed at reviewing courts which forbids judges to uphold agency action on the basis of rationales offered by anyone other than the proper decisionmakers"). The Commission stated its rationale for denying Rapoport's Rule 155(b) motion in its order. JA 19–23. The Commission's iteration of this rationale in its brief—and its explanation, in response to Rapoport's arguments, that the Commission is not bound by how some courts supposedly interpret an inapplicable Federal Rule of Civil Procedure—is not a post hoc rationalization.

Respectfully submitted,

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February 16, 2012

CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the Court's order of February 6, 2012 because it is limited to ten pages, excluding the cover, tables, and certificates of compliance and service.

I also certify that this brief has been prepared in a proportionally spaced typeface using Word Perfect in 14-Point Times New Roman.

/s/ Jeffrey A. Berger
Jeffrey A. Berger

February 16, 2012

CERTIFICATE OF SERVICE

I hereby certify that on February 16, 2012, I electronically filed the original of the Commission's Supplemental Brief, which was served on all parties via the Court's CM/ECF system, and sent eight paper copies to the Clerk of the Court via UPS. Additionally, I sent two courtesy copies of the brief to the following counsel of record via UPS:

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